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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Tariff Filing Requirements for Nondominant Common Carriers	)	CC Docket No. 93-36

PETITION OF AD HOC TELECOMMUNICATIONS USERS COMMITTEE FOR PARTIAL RECONSIDERATION

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

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SUMMARY

The Memorandum Opinion and Order (MO&O) in this proceeding has established a regime wherein the long-term commitments of nondominant carriers will be fundamentally unenforceable -- even when such commitments are fully tariffed. If uncorrected, this flaw threatens to prevent the achievement of the Commission's avowed purpose -- to streamline regulation of nondominant carriers to best replicate the unregulated marketplace.

Although it recognized this problem in the MO&O, the Commission declined to take steps to address it, for reasons that simply do not hold water. First, the Commission suggested that no nondominant carrier would dare abrogate its contracts in a competitive market. Yet both theory and experience show competitive forces alone are not sufficient to assure that contracts are honored. To assure that contracts serve their purpose of facilitating efficiency-enhancing exchanges of resources in the marketplace, it is necessary that they be made legally binding. Moreover, the Commission's suggestion that customers protect themselves contractually begs the question, since those protections would themselves be subject to unilateral abrogation by the carrier.

The Commission should reconsider its order and adopt the procedural and substantive mechanisms recommended by the Ad Hoc Telecommunications Users Committee and other users to assure the enforceability of contracts.

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The Ad Hoc Telecommunications Users Committee (Ad Hoc Committee) hereby submits its petition for partial reconsideration of the Commission's Memorandum Opinion and Order (MO&O) released August 18, 1993, in the above-captioned proceeding.

I. INTRODUCTION.

The purpose of the Commission's action in this docket is unassailable -- to fashion tariffing procedures for nondominant carriers that both satisfy the requirements of Section 203 of the Communications Act of 1934, as amended, 47 U.S.C. § 151 et seq., and frees these carriers to act to the maximum extent possible as though they were in a fully competitive, unregulated industry. For the most part, the actions taken by the Commission in the MO&O further this goal.

But in one glaring respect, the Commission has erred -- and erred badly. The legal mechanism that is central to an unregulated marketplace is the contract. But the Commission has created a regulatory regime in which, to put it bluntly, nondominant carriers' contracts will not be

worth the paper they are written on. Unless the Commission acts to rectify this error, sophisticated users will have a strong disincentive against doing business with many non-dominant carriers. And unsophisticated users are likely to face situations in which non-dominant carriers flout what the users thought were firm commitments.

Can the Commission <u>really</u> have intended to establish a marketplace in which there are no enforceable contracts? This seems out of the question: such a result would be antithetical to the workings of the market as it is known in the United States. Yet by the short shrift its order gives the issue, the Commission essentially suggests that whether carriers keep or break their contracts is none of its business. Unfortunately, under current law the tariff is the document that governs the contract between a carrier and a user, and by law the Commission is the gatekeeper for tariffs; accordingly, maintaining the enforceability of carrier contracts is not only the Commission's business but its inescapable responsibility.

In its comments herein, the Ad Hoc Committee set forth in detail the loophole in the Commission's proposed maximum streamlining procedures for nondominant carriers that would effectively excuse nondominant carriers from being bound to their agreements.[1/] The Committee proposed

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1/ See Ad Hoc Committee Comments, filed March 29, 1993, at 6-8.

a series of procedural mechanisms for preventing nondominant carriers from unilaterally abrogating their contracts, while still permitting carriers to effectuate easily and quickly new service offerings that do not abrogate contracts and allowing the speedy tariffing of consensual renegotiations. The Commission rejected this set of proposals. As will be seen herein, the Commission's action was arbitrary, capricious and without substantial support in the record. For this reason, the Commission should partially reconsider its MO&O and adopt the contract-protecting mechanisms proposed by the Ad Hoc Committee.

II. THE COMMISSION MUST RECONSIDER ITS FAILURE TO ADOPT MECHANISMS FOR ASSURING THE ENFORCEABILITY OF LONG-TERM AGREEMENTS.

A. The Commission's Order Is Based On A Complete Misunderstanding Of The Role Contracts Play In A Free Market.

Remarkably, the Commission seems to realize that the effect of maximum streamlining will, unless safeguards are built in, free nondominant carriers to abrogate their contracts whenever and however they please. By allowing carriers to file tariffs on one days' notice, without checking to see whether the filings alter the terms of existing long-term agreements, the Commission is effectively allowing carriers to abrogate their contracts at any time simply by filing an inconsistent tariff, because as a matter of black-letter law, the tariff supersedes the contract in such a situation. Citing the Supreme Court's recent Maislin

case and the classic ABC v. FCC case,[2/] the MO&O (id.) acknowledges: "[W]e are cognizant of the concerns raised by telecommunications users regarding the abrogation of existing contracts when carriers file tariffs . . . ."[3/]

Despite its recognition of the issue, the Commission is "not persuaded" that corrective measures are needed. MO&O at para. 25. The Commission cites two reasons for not adopting such measures. Its first reason is as follows:

> [W]e believe that in light of the robust competition that has emerged in the telecommunications marketplace in the past decade as well as the nondominant carriers' lack of market power, it is highly unlikely that nondominant carriers would unilaterally raise contract rates in tariff filings. As the carriers themselves have noted, any carrier choosing to alter materially an existing long-term service agreement through the tariff process, without first consulting the user, would risk harming its reputation and position in the competitive telecommunications marketplace.

Id. In other words, the MO&O concludes that no legal mechanisms for enforcing contracts are needed in a

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2/ Maislin Industries v. Primary Steel, Inc., 497 U.S. 116, 127 (1990); American Broadcasting Companies v. FCC, 643 F.2d 818 (D.C. Cir. 1980).

3/ The Commission's phrasing suggests that it may believe the problem only arises initially, when transactions that were formerly covered solely by contracts are memorialized in nondominant carriers' initial tariff filings under the new regime. If so, this belief was incorrect. Nondominant carriers can use the loophole created by the Commission's new rules to abrogate contracts today, tomorrow or five years from now, even if the contracts have been properly tariffed as an initial matter.

competitive market, on the theory that competitive forces themselves will assure that contracts are not breached in the first place.

Competition in the telecommunications marketplace is both an undeniable fact and clearly beneficial to the public. But the assertion that competition alone will enforce contracts is wrong as an empirical matter: the law digests are overflowing with cases in which -- in fully competitive markets -- vendors sought to avoid performance of their contracts. In the state courts, just since the end of 1991, LEXIS shows 5,528 cases in which the word "breach" appears within three words of the word "contract" (and of course these are only reported cases). The common law courts have spent hundreds of years developing the law of contracts to settle commercial disputes in competitive markets. By the Commission's reckoning, these courts' efforts, not to mention those of the litigants and attorneys involved, must constitute one of the most colossal wastes of time in the history of human endeavor.[4/]

4/ Moreover, in at least one case of which the Ad Hoc Committee is aware, a nondominant carrier has successfully taken the position that an attempt by a customer to allege contract rights inconsistent with the filed tariff was legally untenable. See Brookman & Brookman, P.C. v. MCI, 86 Civ. 7040 (CSH), S.D.N.Y. (judgment entered June 19, 1991). MCI was evidently not deterred by competitive forces from relying on its tariff in the face of an allegedly inconsistent contract.

Of course, competition alone will not enforce contracts. The converse is true: it is the legal enforceability of contracts that has served as the backbone in the development of the modern markets in which vigorous competition takes place. As Professor (now Judge) Posner has explained, the law recognizes the "importance of voluntary exchanges (normally of goods or services for money) . . . in moving resources from more to less valuable uses." R. Posner, Economic Analysis of Law at 79 (3d ed. 1986). Posner notes that when the exchange is simultaneous -- the customer hands over the money at the same time as the vendor performs the service or delivers the goods -- there is little or no need for the law to intervene. It is when the exchange includes a promise by one or both parties to take specified actions in the future that "two dangers to the process of exchange arise -- opportunism and unforeseen contingencies -- for which the law offers remedies." Id.

Posner agrees that there are extra-legal consequences -- such as loss of commercial reputation -- that deter casual contract breaking. But, he notes, relying on these consequences as a sole remedy would be a massively inefficient means of assuring that the exchange system works properly. Moreover, such a remedy is ineffective in many cases in which the immediate reward to the contract-breaker to be gained by breach of an agreement would outweigh any harm to reputation he would suffer. Id. at 81. He goes on:

> Thus the fundamental function of contract law (and recognized as such at least since Hobbes's day) is to deter people from behaving opportunistically toward their contracting parties, in order to encourage the optimal timing of economic activity and make costly self-protective measures unnecessary.

Id., citing T. Hobbes, Leviathan 70-71 (1914 ed.; originally published 1651). Posner offers a lengthy analysis of the manner in which contract law serves as the mechanism for the voluntary exchanges that are the atoms of which a free market is composed. Id. at 81 et seq.

Posner's analysis is echoed, with minor variations, by many legal scholars that came both before and after him. Recent articles that discuss contract remedies as mechanisms for ensuring the efficient working of the marketplace include: Goetz & Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 Yale L.J. 1261 (1980); Farber, Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract, 66 Va. L. Rev. 1443 (1980); Goetz & Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, 77 Colum. L. Rev. 554 (1977); Goetz & Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 Va. L. Rev. 967 (1983); Jackson, "Anticipatory Repudiation" and the Temporal Element of Contract Law: An Economic Inquiry Into Contract Damages in Cases of Prospective Nonperformance, 31 Stan. L. Rev. 69

(1978); Ulen, The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies, 83 Mich. L. Rev. 341 (1984); Barton, The Economic Basis of Damages for Breach of Contract, 1 J. Legal Stud. 277 (1972). A number of these commentators specifically reject reliance on non-legal remedies of the kind the Commission relied on as a substitute for legal enforceability. See, e.g., Ulen, supra, 83 Mich. L. Rev. at 347-49.

Recent events in the real world have borne out the commentators' rejection of reputation and market forces as sufficient to enforce contracts. In 1991, when the Supreme Court ruled in the Maislin case (cited above) that trucking companies could rely on ICC-filed tariffs to abrogate contracts and could sue customers for "undercharges," near-chaos ensued. A number of trucking companies that were struggling evidently found it more profitable to serve as collection agencies on their own past "undercharges" than to continue competing with a tight or no margin. These companies (or their bankruptcy trustees) pursued customers with vigor, and were not in the slightest dissuaded by the thought of harm to their own reputation. On the order of a half-million claims for such "undercharges" have been filed, and the total customer cost reportedly could reach $32 billion. See, e.g., Victor, Let the Buyer Beware, 25 National Journal 1730 (July 3, 1993).

The Commission is walking down a very dangerous road if it does not take steps now to avoid the crisis enveloping trucking customers. The steps needed are detailed in the Ad Hoc Committee's initial and reply comments herein. Briefly put, when a carrier files a tariff revision, it should certify whether or not the revision would alter the terms of one or more existing long-term commitments without the consent of affected customers. If it would, the following steps should apply:

- All affected customers should be given at least fifteen days' advance notice of the filing.
- The carrier should be required to identify in its filing the changes to long-term arrangements that it seeks to make, and should state what it believes constitutes substantial cause for such changes.
- The filing should be made with a lengthened notice period. The Ad Hoc Committee recommended forty-five days; others, such as TCA (Comments at 7), proposed a full 120 days.
- The Commission should, as a matter of course, suspend and investigate all such filings. The Commission should also use the rejection mechanism where the purported substantial cause justification is missing, is inadequate on its face or is conclusively refuted in petitions opposing the filing.
- In the event that, notwithstanding the above, such a filing ultimately becomes effective, any affected customer should have the absolute right to terminate its commitment with no liability whatever.

See, e.g., Ad Hoc Committee Reply Comments, filed herein on April 19, 1993, at 3-6.

As a substantive matter, in applying the "substantial cause" test for determining whether such filings should be allowed to take effect, the Commission should adopt doctrines that have been used by courts -- *in competitive markets* -- to decide whether a vendor of goods or services should be excused from performing its contractual obligations. These are the doctrines known variously as "impossibility" and "frustration of purpose,"[5/] "commercial impracticability," or "failure of presupposed conditions."[6/] In this way the Commission can assure that long-term agreements serve the same function that they do in the unregulated commercial world, without having to reinvent the wheel, and without running afoul of the Communications Act's requirements. The Ad Hoc Committee urges the Commission to adopt these proposals for assuring that competition continues to work in the telecommunications marketplace.

5/ *See* 18 S. Williston and W. Jaeger, *Williston on Contracts* 1 *et seq.* (3d Ed. 1978) (cited herein as "*Williston on Contracts*"); *Restatement (Second) of Contracts* §§ 261 *et seq.* (1979) (cited herein as "*Restatement*").

6/ Uniform Commercial Code (UCC) § 2-615.

B. The Commission's Belief That Customers Can Protect Themselves By Negotiating Contractual Protections Is Patently Illogical, Since Nondominant Carriers Can Abrogate These Protections Too By Filing Inconsistent Tariffs.

The Commission's second reason for not adopting measures to enforce long-term agreements is stated as follows:

> Moreover, we believe that large telecommunications users that usually negotiate such long-term service arrangements[1/] possess sufficient leverage in the market to discourage nondominant carriers from choosing a course of action harmful to the users' interests. With respect to the ability of users to be relieved of liability for the termination of contractual arrangements if a tariff is subsequently filed that unduly harms users, we expect that the changed regulatory circumstances will be a factor parties will take into account when they are negotiating contracts.

MO&O at para. 25. Evidently, the Commission believes that large users can simply negotiate adequate protections as part of their contract.

But this is simply wrong. Suppose, for example, that a customer negotiates for a contractual provision enabling the customer to terminate without liability in the event of adverse tariff changes. Suppose further that, it its initial tariff filing embodying the agreement, the carrier includes the provision allowing termination without

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1/ There is, by the way, no evidence in the record that only, or even primarily, "large" users negotiate long-term service arrangements. Certainly, the half-million defendants in the claims filed in the aftermath of Maislin cannot all have been large companies.

liability.[8/] If, a year (or a day) later, the carrier files tariff revisions doubling the rates, all it must do is to remember to delete the tariff provision providing for termination without liability and substitute language along the lines of the following:

> Any customer terminating service hereunder prior to the expiration of the service term will, without exception, be liable for a termination charge of ten million dollars ($10,000,000).

So much, at that point, for the protection negotiated by the customer.

The Commission notes in passing that it will entertain case-by-case complaints in situations in which carriers abrogate their commitments. But the Commission's casual attitude ignores the fact that, without the appropriate procedural safeguards at the time the tariff is filed, such an action may well be deemed to constitute a retroactive rejection of the carrier's tariff -- which is permissible only in extraordinary circumstances. See e.g., Security Services Inc. v. P-Y Transportation Inc., 6th Cir.

8/ By focusing on the right of customers to terminate without liability in the event the carrier breaches its commitment, we do not mean to minimize the importance of other contractual remedies -- such as damages -- in assuring that contracts serve their intended propose in the marketplace. The legal and economic scholars cited above cited above dwell at length on the reasons for and importance of such remedies. By setting up a system whereby, to the maximum extent possible, tariffs mirror rather than contradict the provisions of the underlying contract, the Commission will ensure that a legally enforceable document exists upon which the customer will be able to sue for remedies.

No. 93-3992, Aug. 30, 1993 (summarized in U.S. Law Week, daily edition, Sept. 7, 1993).

To all of this, the rational response of the sophisticated customers of whom the Commission speaks -- many of whom are aware of the Maislin case and the problems it poses -- will simply be to avoid doing business with any carrier whom they believe may ever encounter financial difficulties, since it is those carriers that can be expected to be the first to sacrifice reputation in a situation like that arising in Maislin.[9/] The more risk-averse will show an increasing reluctance to do business with nondominant carriers of all stripes.

Third-tier-and-below carriers will be directly harmed by this marketplace effect. Sophisticated users will be harmed by the loss of realistic marketplace alternatives. Unsophisticated users will be harmed to the extent that they will not be able to rely on what they believed were firm carrier commitments and in some cases may face massive exposure for back "undercharges." The mechanisms proposed by the Ad Hoc Committee and other users will minimize the risk of such harm occurring, and we urge the Commission on reconsideration to adopt those mechanisms.

9/ But note as mentioned above that even financially strong carriers such as MCI have been known to use the filed rate doctrine as a means of avoiding an alleged contract.

III. CONCLUSION.

The Commission's refusal to take steps in the MO&O to assure the enforceability of carrier commitments appears to have been founded on misconceptions as to the role of contracts in the marketplace and as to the alternative remedies it believed were available to users. We urge the Commission to put aside those misconceptions and take the necessary steps to assure that contracts in this industry are as solid as those in other industries.

Respectfully submitted,

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